Predictable Surprises:
The Disasters You Should Have Seen Coming and How You Can Prevent Them
Reducing Costs When Capacity is Tight & Higher Rates are on the Horizon

The Key Question: Are you a Status Quo or Proactive Company?
You have a transportation choice to make:

Choice # 1
You can sit back and watch your freight costs go up by as much as 20-25% over the next 2-3 years, or you can be proactive and actually reduce your transportation costs by 15%-20%.

Choice # 2
Or you can look to the future, consider predictable surprises and be proactive in changing your supply chain and transportation practices and processes to lower your transportation costs by 20%.

What does this look like practically?
Let's say your annual transportation spend is $10,000,000:

	Status Quo Shipper	Proactive Shipper
Annual Spend	$10,000,000	$10,000,000
Increase/Decrease based on Processes and Practices	20%	-20% (from increased amount)
Future Spend	$12,000,000	$9,600,000

A proactive shipper can save 20% off what the status quo shipper will pay in the future, in this case a savings of $2,400,000. How important is 20% or $2,400,000?

Last year, columnist Dan Gilmore asked me: Based on what I am seeing I see a supply chain storm on the horizon where shippers and 3PLs could see their rates increase by as much as 20% - 25% over the next two to three years. Are you seeing the same things, or am I missing something?

Dan's Point: After five years of relative calm in the supply chain area, things were changing, and shippers and 3PLs would find it challenging to control their transportation costs and avoid significant increases in their transportation costs.

Why the concern? Because a Supply Chain Storm could be on the horizon.

These factors could greatly impact your transportation budget.

Wage increases (To address driver retention)	14%
Hours of Service Rules Changes	2%
Independent Contractors Moving to Full Time Employees	3.3%2%
Electronic Logging Devices	1.3%
Diesel Tax Increases	

And the bottom line is

Your company could see rate increases of 22.6%!

That, of course, is in addition to general inflation and leaves out other factors, such as increased costs for new equipment, speed limiters insurance and other costs of doing business.

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How did this storm come about?

2008-2013 — Shippers saw reasonable capacity, fairly stable pricing (in all modal sectors), and may have been lulled in to a sense of complacency. There was little new federal legislation or new rules with a significant impact on motor carrier productivity.

Q4 2013-2014 – Capacity tightened due to weather events, port disruptions, economic growth, etc.

We've learned that the threat of supply chain disruptions is real. Trucking rates could go up by as much as 20-25% over the next 3 years!

Shippers and 3PLs were surprised by carrier rate increases (in different forms) over the past 18 months. But weren't these types of increases predictable?

Some examples beg the question:

Did they see it coming?

- Carrier submits 17% increase. Shipper thinks this is the start of negotiations. Carrier's response: We will cancel the contract if we don't get the 17% increase.
- In the LTL market, the impact of Density and Dimensional Pricing results in Carrier re-classifying freight from Class 70 to Class 92.5.
- TL carriers taking 50% to 100% increases in accessorial charges to reflect their "reality."
- Seller's market for carriers triggers abrupt 30/60/90 day contract cancellations.

So how will this impact your company?

Based on a known set of variables that are likely to occur, or continue over a sustained period of time, you can use Scenario Planning to anticipate predictable surprises and how these factors could affect your supply chains.

Questions to Consider:

- Is the driver shortage issue going away anytime soon?
- Will increased Federal Regulations impact carrier productivity and capacity?
- Will carriers continue to emphasize financial health and exercise market discipline?

Remember, you have a choice:
To be proactive, or reactive!

The Predictable Surprise Formula for Transportation

Assess these variables for your motor carriers.

Understand that shippers and 3PLs will be looking at

Financial Health Issues

+

Operational Challenges

+

Economic & Regulatory Issues

=

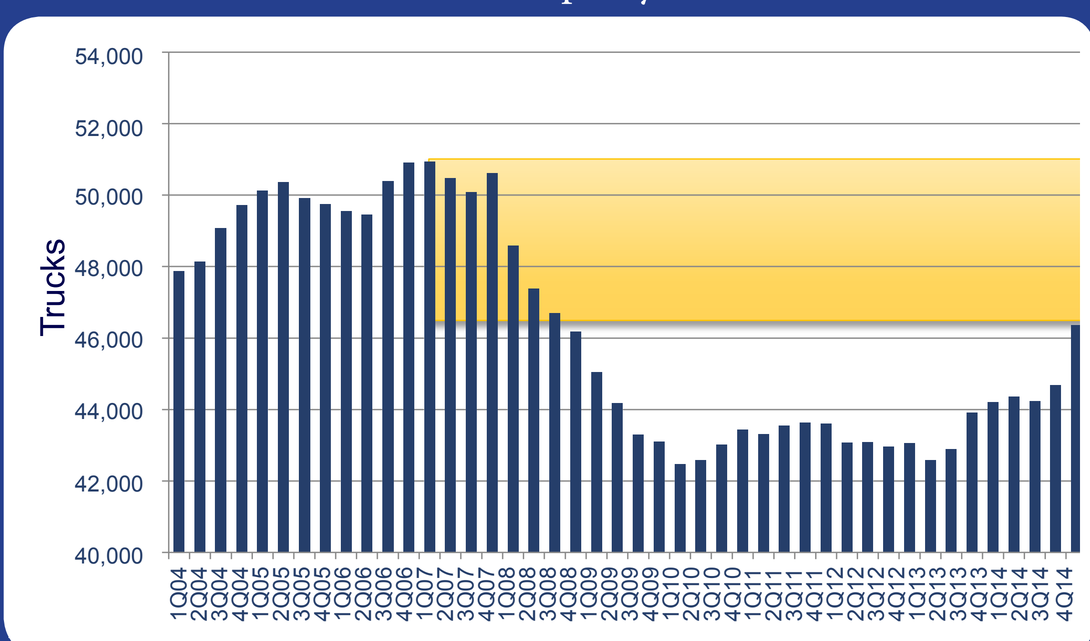
Tighter Capacity & Increased Rates in the Future

Carrier Financial Health Issues

Carriers have had to rebuild their Balance Sheets after the 2008-2012 downturn. Financial analysts have provided a wealth of information that details how financial issues (and balance sheet concerns) have affected operational capacity. Publicly traded truckload carriers have reduced their fleets and overall we have seen a decline in truckload miles per month per truck.

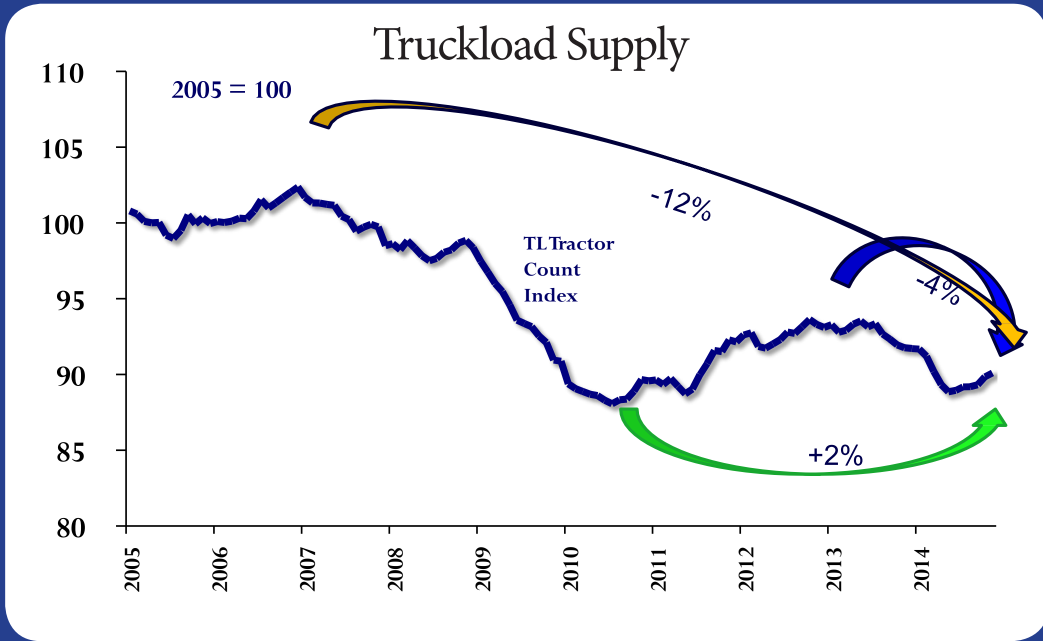
The following charts provide insight into how the financial practices of carriers are impacting truckload capacity.

Total Public Truckload Fleet Capacity



Including owner operators, capacity at public fleets is 9% below peak 4Q06 levels.

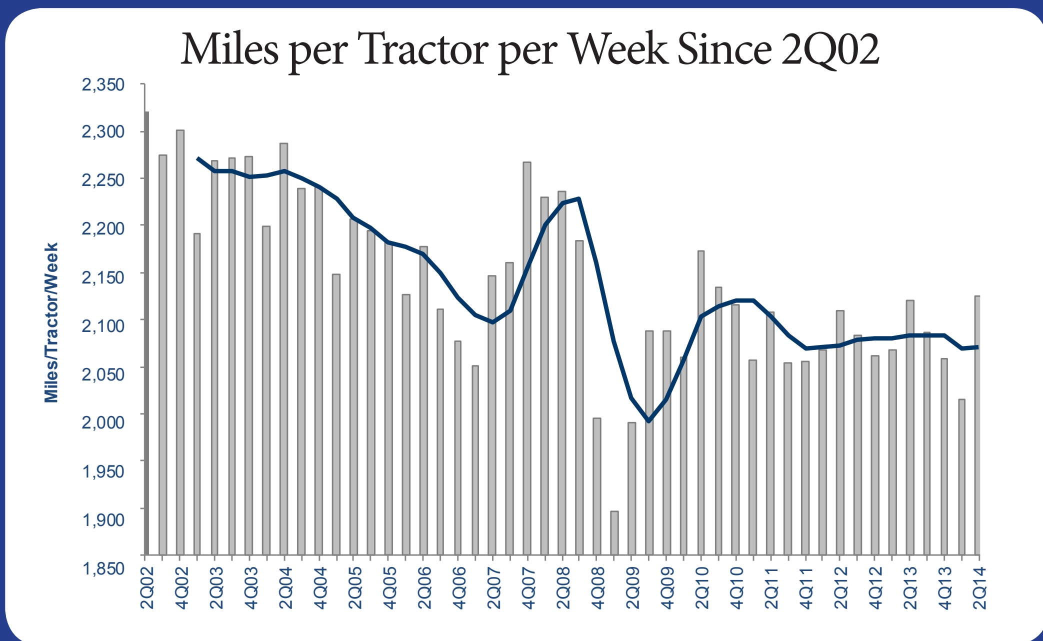
Source: KeyBanc



Whereas 100 trucks per demand were avaiable in 2005, that number dipped to 90 in November, 2014.

This data includes employee driver tractors & independent contractors.

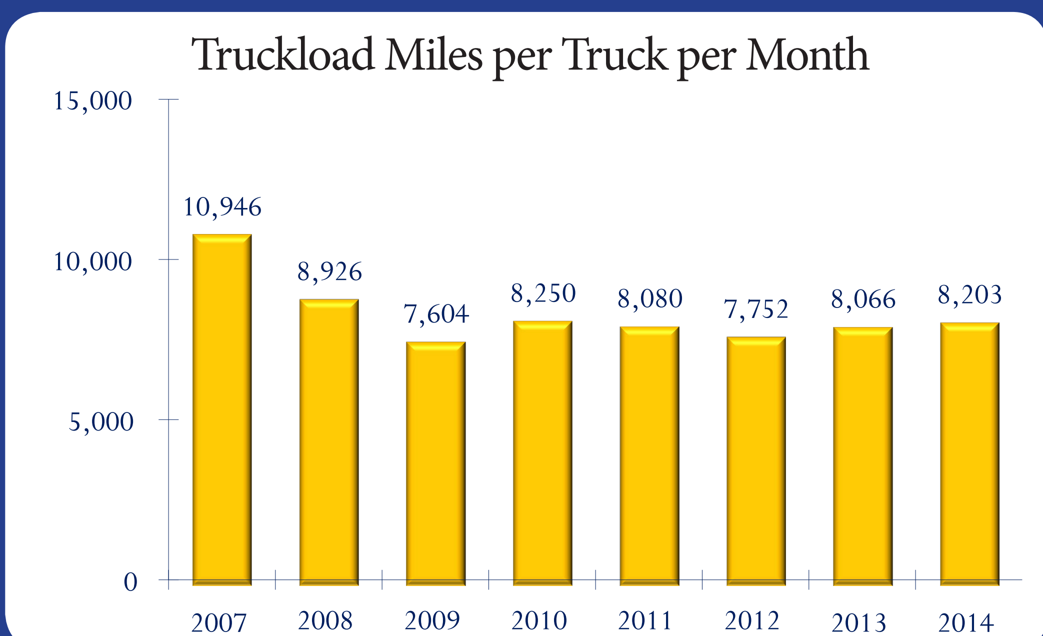
Source: ATA based on Trucking Activity Report



Partly because tractor productivity peaked early last decade, there are few levers left to improve any further.

Data is average of large publicly-traded truckload fleets where available; results include Celadon, Con-way Truckload, Covenant, J.B. Hunt, Knight, Marten, PAM, Swift, USA Truck, and Werner Enterprises.

Source: Company data, Stifel estimates



Truckload miles per truck per month are down 20% since 2007.

This 2014 data runs through November.

Source: ATA

Carrier Operational Issues in the Truckload Sector

There are structural issues negatively impacting trucking companies' cost structure. These issues have a disproportionate impact on small and mid-size trucking companies.

- Driver Retention
- Major increases in important operational categories (e.g. Insurance, cost of equipment, etc.)
- Legislative and Administrative Burdens

At the end of the day, truckers need to make money and have an ROI, or they find something else to do.

The driver shortage is real! No one may actually know how big the driver shortage issue actually is, but we do know that Publicly traded TL carriers are disclosing the number of "parked trucks" due to an inability to seat drivers, which is why TL carriers are increasing driver pay by double digits.

Recruiting, seating and retaining drivers will continue to be the top operational challenge for truckload carriers.

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> "Truckload rates may need to rise as much as 12 to 18 percent to pay for higher driver wages."
>
> -Journal of Commerce, 3/26/15

Carrier Operational Issues in the LTL Sector

LTL carriers want to be paid for the space on their trailers. Lane Densities / Network Footprints are constantly changing, which is why dynamic pricing is on the way. Look for LTL carriers to revise long term contracts to use dynamic pricing to maximize yield and capacity. LTL carriers are getting much better at quantifying the "cost to serve" their customers.

> "Mike, It's easy to understand. Our job is to get our trailers full. After that our job is to cull our least profitable freight and replace it with more profitable freight. Right now, we're pricing all of our new bids with an operating ratio of 90."
>
> -LTL Carrier

The Regulatory Environment and its Impact

Legislatively, there are still real concerns.	• No fully funded, long term Surface Reauthorization (or Highway) Bill is on the horizon, making it less likely legislation will pass to increase carrier productivity, such as allowing larger or heavier trucks on the road. • An extension of the Hours of Service Suspension (which was recently extended in to December, 2015) is in doubt as White House has promised a veto of legislation which would extend it. However, there will be an audit of the controversial FMCSA study of restart rules.
The regulatory environment at Federal Motor Carrier Safety Administration will also impact the freight markets.	• Electronic Logging Devices (ELD's) will be a fact of life by 2016, or 2017 by the latest. Reputable TL carriers report an impact of 4% to 5%, it's a safe bet to assume that it will be at least that much for smaller carriers. • Bills for increased insurance, rules for carrier hiring, and driver health issues threaten "small truckers" and OOIDA (Owner Operator Independent Drivers Association) members. These truckers are the lifeblood of the United States transportation system.
The FMCSA could soon hold shippers accountable for safety issues.	• The latest Driver Coercion Proposal arguably requires shippers, receivers and intermediaries to have discussions with all drivers of all shipments (or maybe all shipments subject to delivery appointments) as to each driver's Hours of Service status and as to the safety of each driver's equipment.
Add in other wild card issues.	• Capacity has been tight with a GDP of 2-2.5%. It will only get worse if we see a greater rate of growth. • Truck driver independent contractor issues are in the courts. Fed Ex's recent decision to settle its independent contractor litigation in California cost $225 Million. • Recent labor negotiations at West Coast Ports are done, but sporadic disruptions are still occurring.

Do you disagree with any of this information? No one does. So make your choice:

PROACTIVE

Ask yourself these questions:

Has my company budgeted for these increases?

When my senior executives look at logistics and supply chain areas for efficiency, what will I do?

Knowing what I know, what is my game plan to reduce costs in an environment where costs are going up?

REACTIVE

Do nothing.

Let your competitors be the proactive ones.

Actually, it only takes one of them to move the bar.

Here's the good news:

Even in an environment of rising rates, there are opportunities to reduce your transportation costs. The keys to reducing your transportation costs are to look at the three P's that drive your supply chain:

Price, Practices and Processes.

While price is an important component in this equation, there are significant saving opportunities in examining your supply chain practices and processes.

Get help from a skilled expert who can help you examine your practices and processes.

These are a few suggestions, but this is just the tip of the iceberg.

Look at your business through the eyes of the carrier, and use their tools for assessment. Obtain the following:

- Carrier Yield Test
- Carrier Scorecard

Look at the factors which drive your transportation costs:

- Read the carrier study on dwell time and detention issues (conducted by Iowa State University), showing cost impact to shippers.
- Look at the advantages of an effective TMS capability
- Study the impact of greater advance notice to carriers in the tendering process.
- Do a Shipment Frequency and CWT analysis
- Consider an Inbound Transportation Management Program (which includes vendor fill rate analysis) and Inbound Consolidation Opportunities.
- Use Optimized Souring Strategies that incorporate lane matching strategies and outbound consolidation opportunities.
- Explore greater efficiencies in your packaging.

How you ship it is just as important as how you make (or buy) it.

Managing in an era of Predictable Surprises is really about priorities. The real question isn't about whether there are savings opportunities available, the real question is whether it is a high enough priority to justify investing the time and resources to do what has to be done to realize those savings.

Be proactive.

Protect your supply chain from the storm.

Here are four key takeaways:

1. How accurate is this forecast? Is there a reasonable probability that that these forward looking predictions will become a reality? What are we doing to prepare for it?

2. Now that I am aware of what is going on in transportation, what will I do with the facts that have been provided? Are there other predictable surprises to consider?

3. f I don't want this crisis to go to waste (and reducing costs/saving money really is a high priority for me and my company), what changes must be made? How will my operations be different one week, one month, or one year from now, based on what I know now?

4. Do I have the support and the tools I need to get the job done? If not, whose support, and what tools, will I need to make the changes that must be made to realize savings?

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Need some help proactively preparing for the storm?
No worries. We are on your team and here to help.

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